

**Tennessee Alcoholic Beverage Commission**  
**October 1998**

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October 19, 1998

The Honorable John S. Wilder  
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Speaker of the House of Representatives  
The Honorable Kenneth N. (Pete) Springer, Chair  
Senate Committee on Government Operations  
The Honorable Mike Kernell, Chair  
House Committee on Government Operations  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Alcoholic Beverage Commission. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the commission should be continued, restructured, or terminated.

Very truly yours,

W. R. Snodgrass  
Comptroller of the Treasury

WRS/ms  
97-092

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit  
**Tennessee Alcoholic Beverage Commission**  
October 1998

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## AUDIT OBJECTIVES

The objectives of this audit were to review the commission's legislative mandate and the extent to which the commission has carried out that mandate efficiently and effectively, and to make recommendations that might result in more efficient and effective operation of the commission.

## FINDINGS

### **Some Food Audits Not Conducted and License Suspension or Revocation Not Initiated**

State law allows restaurants to sell wine and other alcoholic beverages for consumption on the premises if the licensee has adequate kitchen equipment for serving meals, provides seating for at least 75 people at tables, and serves food as its "principal business." The commission completed only 53% of its scheduled food audits to determine if food service was a restaurant's principal business. In some cases, the commission did not attempt to suspend or revoke the licenses of establishments that were serving little, if any, food and/or were not providing the minimum seating (page 6).

### **Licenses Renewed When Licensees Owed Delinquent Taxes**

By renewing licenses when licensees owed delinquent taxes, the commission failed to enforce state statute forbidding such renewals. The licenses of 36% of the liquor-by-the-drink licensees reviewed were renewed even though the licensees owed delinquent taxes. The amount of taxes owed ranged from \$477 to \$24,044 (page 16).

### **No Off-Site Storage of Computer Information**

The commission began entering all information concerning violations, licenses, permits, and server training into computers in 1996. Although the commission backs up the information on disks or magnetic tapes, these back-ups are not stored off-site (page 19).

## **OBSERVATIONS AND COMMENTS**

The audit discusses the following topics that may affect the operations of the commission and the citizens of Tennessee: (1) the server training program, which grants server permits for those who serve alcoholic beverages and monitors programs that provide alcohol awareness training to servers, and (2) liquor-by-the-wire, which is the shipment of alcoholic beverages directly to consumers.

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"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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# **Performance Audit Alcoholic Beverage Commission**

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## **TABLE OF CONTENTS**

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	<u>Page</u>
<b>INTRODUCTION</b>	1
Purpose and Authority for the Audit	1
Objectives of the Audit	1
Scope and Methodology of the Audit	1
Organization and Responsibilities	2
<b>OBSERVATIONS AND COMMENTS</b>	4
Server Training Program	4
Liquor-by-the-Wire	4
<b>FINDINGS AND RECOMMENDATIONS</b>	6
1. The commission failed to conduct some food audits and initiate license suspension or revocation procedures	6
2. The commission's failure to monitor delinquent taxes has resulted in the renewal of licenses when the licensee owed delinquent taxes	16
3. The commission does not have off-site storage of computer information.	19
<b>RECOMMENDATIONS</b>	
Administrative	20

# **Performance Audit Alcoholic Beverage Commission**

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## **INTRODUCTION**

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### **PURPOSE AND AUTHORITY FOR THE AUDIT**

This performance audit of the Tennessee Alcoholic Beverage Commission was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-220 of that statute, the commission is scheduled to terminate June 30, 1999, unless continued by the General Assembly. The Comptroller of the Treasury is authorized, under *Tennessee Code Annotated*, Section 4-29-111, to conduct a limited program review audit of the commission and to report to the Joint Government Operations Committee. The performance audit is intended to aid the committee in determining whether the Tennessee Alcoholic Beverage Commission should be continued, restructured, or terminated.

### **OBJECTIVES OF THE AUDIT**

The audit of the Tennessee Alcoholic Beverage Commission had the following objectives:

1. To determine the authority and responsibility the General Assembly mandated to the commission.
2. To determine the extent to which the commission has met its legislative mandate.
3. To evaluate the commission's effectiveness in regulating the alcoholic beverage industry.
4. To develop possible alternatives for legislative or administrative action which might result in more efficient and/or effective regulation of the alcoholic beverage industry.

### **SCOPE AND METHODOLOGY OF THE AUDIT**

The commission's activities and procedures were reviewed through the fiscal year ended June 30, 1998. The audit was conducted in accordance with generally accepted government auditing standards. The methods used included

1. interviews with commission staff and members, officials from the Department of Revenue, and an alcoholic beverage industry representative;
2. review of statutes and rules;

3. review of the commission's meeting minutes, license files, inspection reports, Server Training provider programs, Server Training Program certified instructor files, consent order files, monthly Activity Reports, and the Department of Revenue's Revenue Integrated Tax System (RITS); and
4. information from the alcoholic beverage industry and the National Conference of State Legislatures.

## **ORGANIZATION AND RESPONSIBILITIES**

### **Purpose of the Commission**

The Tennessee Alcoholic Beverage Commission was established by Chapter 257 of the Public Acts of 1963 (codified as *Tennessee Code Annotated*, Section 57-1-101 et seq.). The commission is responsible for regulating the alcoholic beverage industry (excluding beer, which is regulated by district beer boards). The commission issues the following:

- Annual licenses
  - Manufacturer or distiller or rectifier
  - Liquor wholesaler
  - Liquor retailer
  - Winery
- Three-year employee permits for selling alcoholic beverages at liquor stores
- Three-year server permit cards for serving alcohol at liquor-by-the-drink facilities
- Thirty-day temporary server permit cards

The commission is also responsible for certifying the providers and instructors of the Server Training Program. The commission conducts inspections, issues citations and civil penalties for violations of applicable state law, and provides personnel for the Governor's Task Force for the Eradication of Marijuana.

Fees collected for licenses and permits go directly into the state's general fund, but money seized during drug operations or money from the sale of seized property (weapons, vehicles, etc.) is deposited into a drug fund rather than the general fund. For the fiscal year ending June 30, 1998, the commission received \$1.8 million in state appropriations, collected \$1.2 million in department revenues, and had \$2.9 million in expenditures. According to the Department of Revenue, the alcoholic beverage industry generated tax revenue of \$28.8 million for Mixed Drink taxes and \$28 million for Alcoholic Beverage taxes for fiscal year 1998.

### **Commission Membership and Staff**

According to *Tennessee Code Annotated*, Section 57-1-102, the commission is to consist of three members appointed by the Governor from each of the state's three grand divisions. In



making appointments to the commission, the Governor should strive to ensure that at least one person is 60 years of age or older and that one person is a racial minority. However, as of August 1998, there was not a minority member on the commission. The commission had 52 employees: the executive director, assistant director, chief law enforcement officer, director of the Server Training Program, two training specialists, 31 agents, and 15 support staff as of August 1998. In addition to the central office in Nashville, the commission operates four district offices (Chattanooga, Knoxville, Memphis, and Nashville) and six subposts (Columbia, Cookeville, Greeneville, Jackson, Johnson City, and Winchester).

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## OBSERVATIONS AND COMMENTS

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The topics discussed below did not warrant a finding but are included in this report because of their effect or potential effect on the operations of the Alcoholic Beverage Commission and on the citizens of Tennessee.

### **SERVER TRAINING PROGRAM**

The Alcohol Server Responsibility and Training Act of 1995 (Section 57-3-701, *Tennessee Code Annotated*) requires applicants for server permits to successfully complete a program of alcohol awareness training in order to serve alcohol, wine, or beer. (Servers initially get a temporary 30-day permit until they have completed the training.) The commission has certified six programs in Tennessee and monitors the commission-certified instructors who teach the program material. Each of the six programs includes information concerning Tennessee law, alcohol awareness, serving, prevention, intervention, and personal identification (e.g., checking the age of individuals).

Two commission training specialists monitor the programs for course content and instructor effectiveness. According to the director of the Server Training Program, the commission conducted 66 inspections from October 1997 through June 1998 (the director did not have information for March 1998). On average the training specialists attended eight classes each month. After the class, the specialists complete a Certification Checklist evaluating the trainer and the alcohol awareness program.

The certified instructor files reviewed during the audit contained notices from the training specialists that the instructor did a good job or a notice informing the instructor of weaknesses in the presentation and content of the program. In one instance, the commission also sent a letter to an instructor indicating concern that the instructor had a class of 43 people make a 100% on the test. The commission also monitors whether the program instructors submit the program test results and the \$10 fee for each student within the required 21-day time period. Sixteen active Server Training Program instructor files reviewed contained 86 class registers for the fiscal year ended June 30, 1998. The estimated average time for the commission to receive the test results and fees for these 16 files was 24 days.

### **LIQUOR-BY-THE-WIRE (DIRECT SHIPMENT)**

According to a June 1997 report from the National Conference of State Legislatures (NCSL), direct-to-consumer alcoholic beverage shipments have grown substantially over the last 20 years. Rapid growth in recent years can be attributed to the Internet and catalog wine clubs, beer-of-the-month clubs, malt-of-the-month clubs, and preferred-customer direct marketing.

According to the report, the estimated loss of state taxable revenue ranges widely from \$350 million to nearly \$1 billion annually.

According to the NCSL report, the growth of direct shipping has caused concern in some states because direct shippers can

- avoid state sales and excise taxes;
- bypass the state-sanctioned three-tier systems of production, wholesaling, and retail sales;
- ship beverages illegally to “dry” jurisdictions and minors;
- create an unfair business environment in which only in-state businesses must comply with state regulations; and
- reduce states’ powers to regulate alcoholic beverages within their borders.

The commission cites two problems with suppliers who ship wine and other alcoholic beverages directly to consumers. First, tax revenue is not collected annually on an estimated \$2.45 million to \$7 million liquor sales. Second, citizens under the age of 21 may be receiving alcohol.

*Tennessee Code Annotated*, Section 57-3-603, allows nonresident seller permittees to make sales to licensed wholesalers in the state. The nonresident seller permittee must register the brands of wine and other alcoholic beverages with the Department of Revenue and pay the appropriate taxes (*Tennessee Code Annotated*, Section 57-3-301). The commission stated that statutes are in place to regulate out-of-state (nonresident) suppliers, but all those involved with direct-to-consumer marketing do not follow the statutes. Thus, businesses operating legally and paying taxes compete with companies not paying taxes. One of the problems in controlling direct shipments is the difficulty in determining who is shipping into the state and identifying where and to whom the shipment is going. The chief law enforcement officer at the commission indicated that United Parcel Service notifies the commission when they receive packages they suspect contain alcoholic beverages, but the shippers often do not label packages containing alcoholic beverages making detection more difficult.

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## FINDINGS AND RECOMMENDATIONS

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### **1. The commission failed to conduct some food audits and initiate license suspension or revocation procedures**

#### **Finding**

The commission did not fully carry out its legislative mandate to regulate liquor-by-the-drink (LBD) establishments. *Tennessee Code Annotated*, Section 57-4-101, allows restaurants to sell wine and other alcoholic beverages for consumption on the premises if the licensee has adequate kitchen equipment for serving meals, provides seating for at least 75 people at tables, and serves food as its “principal business.”

The April 1992 performance audit of the Alcoholic Beverage Commission recommended that the commission adopt and implement rules clearly detailing the requirements for a restaurant liquor license, including defining “principal business.” The commission, however, has not established these requirements in its rules or policy manual, but has developed a “Notice and Acknowledgment of Requirements for Obtaining and Maintaining a Restaurant Liquor-by-the-Drink License.” An applicant for a restaurant LBD license is required to sign a statement that the notice has been received and read.

The notice contains the commission’s interpretation of Section 57-4-101: The principal business of an establishment deriving 50 percent or more of its gross revenues from serving meals will be considered a full-service restaurant. However, if an establishment receives less than 50 percent of its gross revenues from food sales, the commission will consider the following factors in determining the establishment’s principal business:

1. The percentage of gross sales obtained from food.
2. Any history of operation as a restaurant without the serving of alcohol.
3. The presence of income-producing activities other than the service of food, the percentage of income derived from such activities, and the priority given to such activities in advertising, etc.
4. The percentage of space allotted to the serving of food as opposed to that allotted to serving alcohol or other activities.
5. The number and percentage of personnel employed in the preparation and serving of food.

6. The diversity of food offered and the times offered.
7. The ratio of investment in equipment and fixtures required in the preparation and serving of food versus the investment in equipment and fixtures for serving alcohol or other income-producing activities.
8. Any other factors indicating an intent to operate as a restaurant and to have as the principal business the serving of meals.

#### Food Audits Not Conducted As Scheduled

To determine if food service is the principal business, the commission performs food audits. These audits are scheduled about three months after a license is issued if there are doubts about whether serving food is the principal business. According to a file review of the 41 licensees the commission planned to audit, the commission sent 36 of the licensees a letter requesting information for a scheduled food audit, but the commission only completed 21 (53%) food audits. (See Exhibit 1.)

#### **Exhibit 1 Restaurant Liquor-by-the-Drink Licensees Selected for Food Audits Calendar Years 1996 through August 1998**

<b>Licensee</b>	<b>License Issued</b>	<b>Food Audit Letter</b>	<b>Food Audit Scheduled</b>	<b>Food Audit Conducted As of 8/21/98</b>
1	1/05/96	1/08/96	5/01/96	Closed 1/31/97
2	1/23/96	1/25/96	5/01/96	5/29/96+
3	2/27/96	2/28/96	6/01/96	6/19/96 & 1/29/97+
4	8/28/97	11/17/95	2/01/96	6/21/96+
5	3/07/96	3/07/96	6/01/96	No
6	3/27/96	3/28/96	6/01/96	No
7	3/29/96	4/01/96	7/01/96	7/11/96+
8	3/13/96	3/14/96	7/01/96	No
9	4/25/96	4/26/96	8/01/96	11/25/96 & 3/26/97+
10	4/30/96	5/08/96	8/06/96	8/06/96+
11	7/10/96	7/11/96	11/18/96	3/11/97+
12	8/01/96	8/02/96	12/01/96	6/02/98+
13	8/05/96	8/06/96	11/01/96	Closed 10/24/96
14	10/23/96	10/24/96	2/01/97	5/30/97+
15	12/03/96	12/05/96	3/01/97	No
16	2/20/97	2/21/97	6/01/97	9/15/97+
17	2/25/97	2/26/97	6/01/97	Closed 6/04/97
18	2/25/97	2/26/97	6/01/97	No
19	3/12/97	3/13/97	7/01/97	10/7/97+
20	3/31/97	4/01/97	7/01/97	No
21	6/04/96	6/05/97	10/01/97	5/26/98+

**Exhibit 1 (Continued)**  
**Restaurant Liquor-by-the-Drink Licensees**  
**Selected for Food Audits**  
**Calendar Years 1996 through August 1998**

<b>Licensee</b>	<b>License Issued</b>	<b>Food Audit Letter</b>	<b>Food Audit Scheduled</b>	<b>Food Audit Conducted As of 8/21/98</b>
22	6/28/96	6/13/97	10/01/97	No
23	5/01/97	No Letter	No	No
24	1/29/97	1/30/97	5/01/97	9/10/97+
25	10/31/96	No Letter	No	6/2/97+
26	7/20/95	7/21/95	11/01/95	3/29/96+
	7/25/97	7/28/97	11/01/97	Closed 4/27/98
27	7/28/97	7/29/97	11/01/97	No
28	7/31/97	8/01/97	11/01/97	No
29	9/25/95	9/09/97	9/09/97	Closed 9/05/97
30	9/10/97	9/12/97	1/01/98	No
31	1/16/98	No Letter	No Date Indicated	No
32	11/13/97	11/14/97	3/01/98	No
33	11/25/97	12/01/97	3/01/98	No
34	11/25/97	12/01/97	3/01/98	No
35	11/26/97	12/01/97	3/01/98	Closed 3/09/98
36	12/18/97	No Letter	No Date Indicated	5/12/98+
37	1/23/98	1/26/98	5/01/98	No
38	6/09/98	6/09/98	10/01/98	NA
39	6/26/96	Hand-Delivered Letter	Requested Information by	6/10/98+
		5/14/98	5/29/98	
40	2/03/98	No Letter	No Date Indicated	5/12/98+
41	11/3/97	No Letter	No Date Indicated	5/8/98+

+ Results of food audit presented in Exhibit 2.

The commission indicated limited staff resources make it problematic to conduct the food audits. The commission said that they have requested a budget improvement so that an auditor position could be added but the commission has not been given the position. The commission's agents must conduct new, renewal, and routine inspections; investigate violations; and serve on the Governor's Task Force for the Eradication of Marijuana. Food audits become a lower priority when agents are given these other assignments.

Exhibit 2 shows the results of 21 licensee food audits. None of the food audits revealed sufficient food sales. Eighteen licensees had three months' food sales below 30% of the businesses' gross sales (food sales percentages ranged from 1.6% to 28%). Warning letters instead of citations were issued to two licensees that had three months' food sales of 34% and 22%. One licensee had a three-month average food sales of 42%, but the agent who conducted the food audit indicated conflicting information concerning food sales receipts and food expenses. As a result of the 21 food audits conducted, the commission issued 12 citations of \$300 each, two citations for \$900 each, and one citation for \$3,000.

In two cases the agent asked for financial information (revenue and expense receipts from different business sources) for renewal inspections a few months after food audits revealing low food sales. The three months' food sales percentages were 13% and 28%. The commission staff renewed the licenses even though the percentages of food sales were low. In both instances, the licensee did not receive a warning letter or citation from the commission (the agent also did not write up a violation report concerning low percentage of food sales). Although no action was taken in these cases, an agent's request for financial information, at the time of a renewal inspection, would allow the commission to monitor whether the licensee's principal business is serving food or serving alcoholic beverages.

**Exhibit 2**  
**Food Audit Results**  
**1996 Through August 1998**

<b>Licensee</b>	<b>Date of Food Audit</b>	<b>Income From Food Sales</b>	<b>Results of Food Audit</b>	<b>License Renewed</b>
2	5/29/96	02/96 food sales 33% 03/96 food sales 35% 04/96 food sales 32% OVERALL 34%	Warning letter	1/23/97
3	6/19/96	03/96 food sales 16% 04/96 food sales 27% 05/96 food sales 19% OVERALL 21%	Citation for \$900, 11/06/96 Consent Order reduced fine to \$600 Paid \$600 over 3 payments	2/27/97
	Renewal Inspection 1/29/97	10/96 food sales 10% 11/96 food sales 11% 12/96 food sales 19% OVERALL 13%	Agent requested food sales information as part of the renewal inspection. License was renewed without any disciplinary action.	
4	6/21/96	12/95 food sales 37% 01/96 food sales 41% 02/96 food sales 27% OVERALL 35%	The assistant director recommended that the case be closed and no action was taken.	9/28/96
7	7/11/96	04/96 food sales 17% 05/96 food sales 16% 06/96 food sales 19% OVERALL 18%	Citation for \$300, 8/26/96 Consent Order paid 12/16/96	3/29/97
9	11/25/96	05/96 food sales 17% 06/96 food sales 23% 07/96 food sales 26% OVERALL 22%	Commission did not issue a citation but encouraged licensee to improve the food sales.	4/24/97
	Renewal Inspection 3/26/97	01/97 food sales 27% 02/97 food sales 28% 03/97 food sales 29% OVERALL 28%	Agent requested food sales information as part of the renewal inspection. The commission renewed the license but took no disciplinary action.	

**Exhibit 2 (Continued)**  
**Food Audit Results**  
**1996 Through August 1998**

<b>Licensee</b>	<b>Date of Food Audit</b>	<b>Income From Food Sales</b>	<b>Results of Food Audit</b>	<b>License Renewed</b>
10	8/06/96	05/96 food sales 13% 06/96 food sales 21% 07/96 food sales 19% OVERALL 18%	Seating was less than the minimum 75 at tables. Citation for \$300, 11/08/96 Consent Order paid 12/03/96	4/30/97
11	3/11/97	08/96 food sales 7.5% 09/96 food sales 8.5% 10/96 food sales 7.7% OVERALL 8%	Citation for \$900, 4/22/97 Consent Order paid 6/03/97	7/10/97
12	6/02/98	01/98 food sales 5.7% 02/98 food sales 5.7% 03/98 food sales 4.4% 04/98 food sales 3.8% OVERALL 4.9%	Citation for \$300, 8/10/98 Consent Order not paid as of 8/11/98	8/01/98
14	5/30/97	02/97 food sales 8% 03/97 food sales 12% 04/97 food sales 13% OVERALL 11%	Citation for \$300, 7/017/97 Consent Order paid 8/4/97	10/23/97
16	9/15/97	05/97 food sales 18% 06/97 food sales 11% 07/97 food sales 29% OVERALL 18.4%	Citation for \$300, 11/19/97 Consent Order paid 1/6/98	3/03/98
19	10/07/97	06/97 food sales 4% 07/97 food sales 10.6% 08/97 food sales 4.7 % OVERALL 6.4%	Citation for \$300, 11/21/97 Consent Order paid 2/12/98	Business closed 3/11/98
21	5/26/98	01/98 food sales 4.8% 02/98 food sales 3.2% 03/98 food sales 5.2% OVERALL 4.4%	Citation for \$300, 8/14/98 No Consent Order as of 8/14/98	6/04/98
24	9/10/97	05/97 food sales 9% 06/97 food sales 11% 07/97 food sales 5% OVERALL 8.6%	Citation for \$300, 10/3/97 Consent Order paid 10/31/97	1/29/98
25	6/2/97	12/96 food sales 11.2% 01/97 food sales 15.9% 02/97 food sales 17.5% OVERALL 14.9%	Citation for \$300, 8/19/97 Consent Order paid 9/11/97	10/31/97
26	3/29/96	08/95 food sales 3% 09/95 food sales 4.7% 10/95 food sales 3.58% OVERALL 3.9%	Citation for \$3,000, 7/15/96 Consent Order reduced to \$2,500, paid 7/23/97	7/20/96



**Exhibit 2 (Continued)**  
**Food Audit Results**  
**1996 Through August 1998**

<b>Licensee</b>	<b>Date of Food Audit</b>	<b>Income From Food Sales</b>	<b>Results of Food Audit</b>	<b>License Renewed</b>
36	5/12/98	01/98 food sales 26.7% 02/98 food sales 63.9% 03/98 food sales 36.2% OVERALL 42%	Citation for \$300, 6/02/98 The agent indicated that there were no sales receipts of items or quantity sold. The food expenses for the months of operation are conflicting. The agent stated that he did not feel that the establishment held itself out as a place where meals are regularly served.	12/18/97
39	6/10/98	01/98 food sales 1.5% 02/98 food sales 1.4% 03/98 food sales 2.0% OVERALL 1.63%	Citation not issued as of 8/06/98	6/26/98
40	5/12/98	01/98 food sales 11.4% 02/98 food sales 10.4% 03/98 food sales 10.9% OVERALL 10.9%	Citation for \$300, 6/01/98 Consent Order paid 6/22/98	2/03/98
41	5/08/98	01/98 food sales 2.8% 02/98 food sales 2.7% 03/98 food sales 2.8% OVERALL 2.8%	Citation for \$300, 5/22/98 Report of violation stated Assistant Director requested food audit by agent in follow-up to seating violation	

**License Suspension or Revocation Procedures Not Initiated in Some Cases**

The LBD Notice, which the licensee must read and sign, states that if the commission determines the establishment is (1) not operating as a full-service restaurant, and/or (2) fails to meet and/or maintain the requirements for a restaurant liquor-by-the-drink license, disciplinary action will be taken. Such disciplinary action may include revocation proceedings. As illustrated in Exhibit 3, the commission did not suspend or revoke licenses of establishments that were not meeting the requirements to have a restaurant liquor-by-the-drink license. In some cases, establishments appeared to be selling little, if any food, and/or were not providing seating for at least 75 people at tables.

In these instances where the licensee obviously had violated the statutes concerning liquor-by-the-drink licenses, the commission failed to perform its statutory responsibility and initiate license revocation or suspension proceedings [*Tennessee Code Annotated*, Sections 57-3-214 and 57-4-102 (19)(A)]. In one instance, the licensee was not even issued a citation by the commission staff. The commission's lack of action provides these licensees an unfair advantage over those meeting the restaurant LBD requirements or making a honest effort to meet the requirements. The commission's lack of disciplinary action also encourages other licensees to violate the restaurant LBD requirements.

**Exhibit 3**  
**Liquor-by-the-Drink Licensees**  
**Restaurant Violations**  
**Calendar Years 1995 Through August 1998**

<b>Licensee</b>	<b><u>Violation</u></b>	<b><u>Fine</u></b>	<b><u>Inspection or Food Audit Date</u></b>	<b><u>Renewed License</u></b>
<b>2</b>	<p><u>Consent Order #3746</u> : Failure to maintain restaurant seating at the minimum 75 (RI #95-0653). Identified only 23 seats during renewal inspection.</p> <p>The total seating at tables and open to the public was 13 with 10 bar stools, for a combined total of 23. Manager said restaurant was open only four days per week and did not have any full-time cooks. Manager also stated that the food items mostly consisted of chips, salsa, popcorn, candy, and crackers. No menu was available at the time of inspection. The kitchen area appeared to be closed down and used to store building materials.</p> <p>Agent could not locate business on 7/12/96. Called the number listed as the business number and got a recording: The business temporarily closed 6/22 but would be open for social hour on Friday's. No notice to the commission about closing.</p> <p>Agent attempted to locate business concerning complaints and to follow up citation. Agent was unable to locate business. Agent permanently voided license on 2/26/97.</p>	\$100	10/17/95	10/26/95
<b>4</b>	<p><u>Consent Order #3549</u>: Failure to maintain restaurant seating at the minimum 75 (RI #96-0041). Identified only 59 seats during renewal inspection.</p> <p><u>Consent Order #3964</u>: Failure to maintain restaurant seating at the minimum 75 (RI #96-0682). Identified only 48 seats during renewal inspection.</p>	\$500	1/17/96	1/30/96
		\$200	12/20/96	1/30/97
<b>6</b>	<p><u>Consent Order #3959</u>: Failure to maintain requirements for restaurant LBD (RI #96-0567).</p> <p>During renewal inspection, agent observed that the establishment was not attempting to sell food. There was a limited amount of frozen food, and walk-in cooler and refrigerator were storing wine and beer only. The agent also observed that the establishment was not stocked with any condiments, such as mustard, ketchup, or mayonnaise. There were no kitchen utensils such as pots and pans. The manager could not locate a menu.</p>	\$300	10/10/96	10/24/96
<b>7</b>	<p><u>Citation Issued</u>: Citation (RI # 66-0460) was never paid. Failure to maintain requirements for a restaurant LBD.</p> <p>New inspection noted that all the dining tables were 18" in diameter and not adequate for food service. Commission mailed letter telling licensee to comply with minimum standards.</p>	\$1,000	6/03/96	5/31/96

**Exhibit 3 (Continued)**  
**Liquor-by-the-Drink Licensees**  
**Restaurant Violations**  
**Calendar Years 1995 Through August 1998**

<u>Licensee</u>	<u>Violation</u>	<u>Fine</u>	<u>Inspection or Food Audit Date</u>	<u>Renewed License</u>
7	<p>Agent returned 7/18/96 to determine if minimum requirements had been met. There were no chairs or tables; no food was being served. An inspection of the kitchen did not indicate any food was available. Agent recommended license be revoked for failure to maintain minimum seating and failure to provide adequate food service.</p> <p>On 12/06/96, agent was accompanied by Metro Environmental Task Force. Arrived at approximately 10:00 p.m. There were 26 18" diameter cocktail tables. Apparently the only food prepared and available was a tray of fried chicken wings. The Metro Health Department Inspector conducted an inspection and scored the facility a 47. The inspector required that all the food be discarded while he was present.</p> <p>12/8/96: Business burned.</p>		7/18/96	
10	<p><u>Consent Order #3924</u>: Failure to maintain the requirements for a restaurant (RI #96-0420).</p> <p>During food audit, the agent believed the establishment was not holding itself out as a place where meals were regularly served.</p> <p>Overall Food Sales about 18% according to food audit.</p>	\$300	7/11/96	3/29/97
11	<p><u>Consent Order #3867</u>: Failure to maintain restaurant seating at the minimum 75 (RI #96-0447). Identified only 49 seats during renewal inspection.</p> <p>On the food audit form, the agent commented that he did not witness any food being served and that the establishment did not appear to hold itself out as a place where meals were regularly served. The level of food on hand was low. Only 72 seats were present when the premises was inspected for the food audit—23 of the seats were located around the bar or at the video machines.</p> <p>Overall Food Sales about 25% according to food audit.</p>	\$300	8/07/96	4/30/97
12	<p><u>Consent Order 3612</u>: Failure to maintain the requirements for a restaurant liquor-by-the-drink license (RI #95-0775).</p> <p>Agent attempted to order food on 12/6/95 and 12/12/95, but no food was available. Food audit indicated that three-month average food sales was about 3%. ABC scheduled Administrative Hearing to revoke license, but licensee signed letter indicating agreement to the terms set forth by citations.</p>	\$1,500	12/06/95 12/12/95	11/03/96

**Exhibit 3 (Continued)**  
**Liquor-by-the-Drink Licensees**  
**Restaurant Violations**  
**Calendar Years 1995 Through August 1998**

<u>Licensee</u>	<u>Violation</u>	<u>Fine</u>	<u>Inspection or Food Audit Date</u>	<u>Renewed License</u>
12	<u>Consent Order 4785</u> : Failure to maintain restaurant seating at the minimum 75 (RI #97-0474). Identified only 38 seats during renewal inspection. Report also noted licensee was in violation during 1996 renewal inspection for having only 42 seats.	\$1,000 reduced to \$400	9/24/97	11/03/97
	<u>Citation Issued</u> : Failure to maintain restaurant seating requirements (RI #98-0159). Identified only 56 seats during routine inspection. Agent reported that food preparation appeared not to be an ongoing process.	\$1,000	2/18/98	Expires 11/02/98
	<u>Citation Issued</u> : Failure to maintain requirements for a restaurant liquor-by-the-drink license (RI #98-479). Assistant Director requested food audit of establishment as follow-up to RI #98-0159. Food audit indicated that three-month average food sales was 3%.	\$300	5/08/98	Expires 11/02/98
17	<u>Citation Issued</u> : Failure to maintain restaurant seating at the minimum 75 (RI #98-0427). Identified 30 seats during routine inspection.	\$100	4/24/98	12/29/97
18	<u>Citation Issued</u> : Failure to maintain restaurant seating at the minimum 75 (RI #98-0513). Establishment did not meet minimum seating requirements during routine inspection	\$100 Dismissed seating citation	5/12/98	12/18/97
	<u>Citation Issued</u> : Failure to maintain requirements for a restaurant liquor-by-the-drink license (RI #98-0481). Food audit indicated that three-month average food sales was 42%, but agent indicated in report that food sales receipts and food expense records were not consistent. Agent did not believe establishment was holding itself out as a place where meals were regularly served.	\$300	5/12/98	12/18/97
20	<u>Citation Issued</u> : Failure to maintain requirements for a restaurant liquor-by-the-drink license (RI #98-0480). Food audit indicated that three-month average food sales was 10.5%.	\$300	5/12/98	2/03/98
23	<u>Citation Issued</u> : Failure to maintain requirements for a restaurant liquor-by-the-drink license (RI #98-0348). Food audit indicated that three-month average food sales was 4%.	\$300	5/26/98	6/04/98
24	<u>Citation Issued</u> : Failure to maintain requirements for a restaurant liquor-by-the-drink license (RI #98-0432). Food audit indicated that three-month average food sales was 5%.	\$300	6/02/98	8/01/98
26	<u>No Citation Issued</u> : Violation identified during renewal inspection. The agent noted in the inspection report that the business did not have a kitchen.	None	4/28/97	5/01/98

**Exhibit 3 (Continued)**  
**Liquor-by-the-Drink Licensees**  
**Restaurant Violations**  
**Calendar Years 1995 Through August 1998**

<u>Licensee</u>	<u>Violation</u>	<u>Fine</u>	<u>Inspection or Food Audit Date</u>	<u>Renewed License</u>
26 (cont.)	This establishment had been able to maintain an LBD License for a number of years because it operated through the use of a deli next door for restaurant services. The agent completed the inspection sheet as it had been done in the past and included kitchen equipment from the deli. The agent believed that this setup was a circumvention of the law and that the establishment should have not been licensed initially or licensed as it currently operated.			

**Recommendation**

The commission should conduct food audits of establishments when routine or renewal inspections identify licensees who are not attempting to promote food sales as the principal business or to maintain the minimum seating requirements. The commission should also consider having agents request financial information during the renewal inspections of licensees that appear to have problems meeting the requirements. The review of the information would not involve the detailed examination of supporting documents but would possibly give the commission an estimate of the licensees' efforts to have food service as the principal business.

The commission should take agents' comments into consideration when a restaurant LBD license is due for renewal. The commission should initiate license suspension or revocation proceedings when an agent has identified licensees that are obviously not making any effort to provide food service or to maintain the minimum seating capacity.

**Management's Comment**

We concur. The performance audit report indicates that the commission completed only 53% of the food audits that were originally scheduled to be conducted for a certain time period. It should be noted that it is very difficult and in some cases impossible to conduct a food audit of an establishment which has ceased operation of its business or indicates that the closing of business is imminent. Based on the establishments that closed within the examined time period, the commission would have completed 66% of the food audits originally scheduled.

The commission does recognize the importance of ensuring that existing law is complied with by liquor establishments. However, as indicated previously, the commission has a very limited personnel base from which many extremely important responsibilities require attention. It

becomes imperative that in certain situations the commission select the area of responsibility requiring the most immediate attention. In addition, the commission has in the past and will continue to request additional personnel with auditing expertise through improvements in the budget for this area. And as indicated in the audit report, the commission has previously formulated and implemented a memorandum of understanding regarding the requirements of obtaining and maintaining a restaurant license of which the individual licensee is required to sign. This was deemed to be less intrusive than the promulgation of additional regulations and more informative to the individual licensee.

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## **2. The commission's failure to monitor delinquent taxes has resulted in the renewal of licenses when the licensee owed delinquent taxes**

### **Finding**

By renewing licenses when licensees owed delinquent taxes, the commission failed to enforce state statute forbidding such renewals. According to a review of 22 liquor-by-the-drink (LBD) licensees, the commission renewed eight LBD licenses (36%) even though the licensees owed delinquent taxes.

### **Monitoring Delinquent Taxes When Renewing LBD Licenses**

*Tennessee Code Annotated*, Section 57-1-207(c), directs the commission not to renew the license of any dealer until all delinquent taxes have been paid and the Commissioner of the Department of Revenue certifies the payment. As a part of the license renewal process for retail sales licenses (i.e., liquor stores), the commission checks whether the licensees have any delinquent sales and use taxes listed on the Department of Revenue's Revenue Integrated Tax System (RITS). If a licensee owes more than \$300 in delinquent sales and use taxes, the commission sends a notice stating that the taxes must be settled with the Department of Revenue before the commission will renew the license.

We reviewed the files of ten retail store licensees and 22 liquor-by-the drink licensees and checked their tax payments on RITS. The auditor did not identify any problems with the renewal of retail liquor store licenses but noted several instances of improper renewal of LBD licenses (see exhibit 4). Seven licensees owed delinquent taxes at the time of license renewal. Two of the seven had been delinquent at least three times in a 12-month period. Section 57-1-207, *Tennessee Code Annotated*, states, "If a dealer is delinquent in paying the required taxes for as many as three times in a calendar year, the commission may revoke the dealer's license."

Denying license renewal, and thereby the right to conduct business, is a powerful incentive to pay delinquent taxes. The failure to use this incentive lessens the commission's effectiveness as a regulatory entity.

**Exhibit 4**  
**Liquor-by-the-Drink Licensees**  
**Delinquent Sales & Use and/or Liquor-by-the-Drink Taxes**

Licensee	Delinquent S&U Taxes (at time of renewal)	Delinquent LBD Taxes (at time of renewal)	License Renewed	Business Closed	Three Months of Delinquent Taxes in 12-Month Period
4	\$1,645	NA	2/16/98	NA	No
5	NA	\$6,403	3/29/98	NA	No
7	\$4,172	\$2,603*	6/12/98	NA	No
8	\$10,362	\$30,077	1/24/98	NA	Yes (LBD)
11	\$3,458	\$4,102	6/26/98	NA	Yes (LBD)
12#	\$477	NA	4/28/98	NA	No
14	\$3,257	NA	2/04/98	NA	No
19	\$23,616	NA	4/15/97	1/22/98	No

\* Delinquent taxes were for May and June and were probably not posted on RITS at the time the license was renewed.

# The licensee file contained documentation that the commission had checked RITS for delinquent taxes at the time the license was renewed.

**Department of Revenue No Longer Sends Commission Delinquent Tax Notification Letters**

*Tennessee Code Annotated*, Section 57-1-207, requires the Commissioner of Revenue to provide the Alcoholic Beverage Commission a written monthly report showing the name of each licensed dealer who is delinquent in paying or remitting tax owed to the state.

The commission stated that it cannot issue a citation for delinquent taxes without the written notification letter from the Commissioner of Revenue because the written notice provides documentation for the issuance of the citation. Department of Revenue staff said that the monthly computer printout of delinquent taxpayers serves the purpose of the notices and thus fulfills the department's statutory requirements. However, the commission would like the department to send either the notice of tax delinquency or a copy of the delinquent tax notice sent to the taxpayer. The commission indicated that a copy of the monthly notice could be placed in the licensee's file, and when the licensee receives three letters in a 12-month period, the commission could issue a citation. According to the Department of Revenue, the Revenue Integrated Tax System (RITS) does not produce duplicate letters, and there is not enough staff in the Tax Division to create the letter for the commission. The Department of Revenue said that the commission has access to RITS and can obtain the information from the system. According to the commission, it has only one person working with retail sales licenses and one person working with LBD licenses and does not have the staff to look up every licensee on the computer report and determine whether the individual should be issued a citation for delinquent taxes. The commission said that RITS was very helpful in monitoring delinquent taxes and bonds when renewing licenses, but was not very helpful in determining when a citation should be issued for delinquent taxes.

Before May 1995, the Department of Revenue sent tax delinquency notices to the commission, and the commission issued citations and fined the licensees \$300 for each month the taxes were delinquent. Since then, the commission has not received the notices from the Department of Revenue and has not issued any citations for delinquent tax violations.

### **Recommendation**

The commission should monitor both the sales and use and liquor-by-the-drink taxes when renewing licenses of LBD establishments. The commission should work with the Department of Revenue to ensure the commission has the information necessary to determine whether these taxes have been paid before renewing a LBD license and to determine when licensees have three or more months of delinquent taxes in a 12-month license period. The commission should also request training from the Department of Revenue on how to use RITS.

### **Management's Comment**

We concur. This is obviously a problematic area which has been a source of concern for the commission for quite some time. Currently, the commission reviews information received from the Department of Revenue via the Revenue Integrated Tax System (RITS), and takes administrative action against individual licensees when warranted.

It should be noted that action taken consists of placing a licensee on temporary void thereby prohibiting a licensee from selling any alcoholic beverages until the delinquency is corrected. However, in several instances after prohibiting a licensee from selling alcohol, the information contained in RITS has been determined to have been inaccurate. Consequently, the commission has penalized a licensee based on information it has received from Department of Revenue, only to be advised soon thereafter that a mistake has been made and a delinquency does not exist.

As referenced in the audit report, T.C.A. §57-1-208 (c) requires that “the commissioner of revenue shall furnish to the commission a written report showing the named of each licensed dealer who is delinquent in the payment or remittance of any tax owing to the State of Tennessee.” It would appear that by providing this written report, a more accurate reflection of accounts can be made and thus the regulatory scheme which currently exists can be better implemented.

Additionally, the commission has adopted procedures by which verification of delinquent taxes is documented.



### **3. The commission does not have off-site storage of computer information**

#### **Finding**

The commission began entering all information concerning violations, licenses, permits, and server training into computers in 1996. Although the commission backs up the information on disks or magnetic tapes, these backups are not stored off-site. Damage or destruction of the commission's offices could mean the loss of irreplaceable information concerning who has a license or permit, when the license or permit expires, and who has completed server training. The commission's regulatory and criminal investigation information also would have to be recreated.

#### **Recommendation**

The commission should develop procedures for storing backup computer information off-site and for regularly backing up the databases to replace the information stored off-site.

#### **Management's Comment**

We concur. The commission is in the process of expanding its computer network to accommodate preservation of all records pertaining to the above finding.

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## RECOMMENDATIONS

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### ADMINISTRATIVE

The following areas should be addressed to improve the efficiency and effectiveness of the Alcoholic Beverage Commission's operations.

1. The commission should conduct food audits of establishments when routine or renewal inspections identify licensees who are not attempting to promote food sales as the principal business or to maintain the minimum seating requirements. The commission should also consider having agents request financial information during the renewal inspections of licensees that appear to have problems meeting the requirements. The review of the information would not involve the detailed examination of supporting documents but would possibly give the commission an estimate of the licensees' efforts to have food service as the principal business.
2. The commission should take agents' comments into consideration when a restaurant LBD license is due for renewal. The commission should initiate license suspension or revocation proceedings when an agent has identified licensees that are obviously not making any effort to provide food service or maintain the minimum seating capacity.
3. The commission should monitor both the sales and use and liquor-by-the-drink taxes when renewing licenses of LBD establishments. The commission should work with the Department of Revenue to ensure the commission has the information necessary to determine whether these taxes have been paid before renewing a LBD license and to determine when licensees have three or more months of delinquent taxes in a 12-month license period. The commission should also request training from the Department of Revenue on how to use the Revenue Integrated Tax System (RITS).
4. The commission should develop procedures for storing backup computer information off-site and for regularly backing up the databases to replace the information stored off-site.